VZCZCXRO5016
RR RUEHAO RUEHCD RUEHGA RUEHGD RUEHGR RUEHHA RUEHHO RUEHMC RUEHNG
RUEHNL RUEHQU RUEHRD RUEHRG RUEHRS RUEHTM RUEHVC
DE RUEHCV #1255/01 1761329
ZNR UUUUU ZZH
R 251329Z JUN 07
FM AMEMBASSY CARACAS
TO RUEHC/SECSTATE WASHDC 9091
INFO RUEHWH/WESTERN HEMISPHERIC AFFAIRS DIPL POSTS
RUEATRS/DEPT OF TREASURY
RHEBAAA/DEPT OF ENERGY
RUCPDOC/DEPT OF COMMERCE
RUMIAAA/HQ USSOUTHCOM MIAMI FL
RHEHNSC/NSC WASHDC

UNCLAS SECTION 01 OF 03 CARACAS 001255

SIPDIS

SENSITIVE
SIPDIS

TREASURY FOR KLINGENSMITH, NGRANT, AND MMALLOY
COMMERCE FOR 4431/MAC/WH/MCAMERON
NSC FOR DTOMLINSON
HQ SOUTHCOM ALSO FOR POLAD

E.O. 12958: N/A
TAGS: ECON EFIN VE
SUBJECT: BORROWING FROM PETER TO PAY PAUL

REF: A. 06 CARACAS 2622

¶B. CARACAS 1138

SUMMARY

¶1. (SBU) Banks have increased loan portfolios by over 54 percent in real terms in the past year and the financial sector is riding this wave of credit to record profits. Fed by excess liquidity and exchange controls that prevent money from leaving Venezuela, Venezuelans are racing to invest in non-tradable goods (real estate, cars, etc.) that maintain value, and are doing so on credit. The rapid increase in credit and the history of boom-bust cycles in Venezuela call into question banks' risk profiles and their abilities to handle a sharp drop in liquidity, which could result from a drop in oil prices, decreases in government spending, or a large devaluation.

GREED IS GOOD

¶2. (SBU) The banking sector's total assets grew by 21.3 percent (in real terms) for the 12 months ending May 2007. The net loan portfolio grew 54.4 percent and deposits grew by 37.9 percent. Consumption loans make up 78.4 percent of the loan portfolio and grew by 59 percent year on year. Credit card debt grew by 114 percent and car loans by 117 percent in the past 12 months.

¶3. (SBU) Banks in Venezuela remain incredibly profitable, with returns averaging 31 percent for the sector, and with one prominent western banker admitting to Econoffs that they had over 50 percent in returns in 2006. Bank profits come from fees, lending, and investments. The recent series of dollar-denominated bond issuances have become profit centers for banks (with one banker claiming an average of 20-30 percent return per transaction), which serve as intermediaries for the purchasers, charging fees, making loans for their clients to buy on margin, and purchasing bonds themselves.

FREE MONEY

¶4. (SBU) Interest rates in Venezuela are fixed, with minimum rates for deposits (6 percent) and CDs (10 percent) as well as maximums for loans (28 percent, though many sectors have lower fixed rates).

Table: Average bank interest rates (in percentages) as of June 22, 2007.

Agriculture	Industry	Commerce	Services
11.91	14.70	17.81	16.04
Mortgages	Transport	Tourism	Communications
16.04	20.28	15.06	14.54
Vehicles	Credit Cards	Other Private Sector	
19.89	26.16	13.63	

(Source: Central Bank of Venezuela)

The average rate paid to depositors is 6.57 percent and the average lending rate overall is 15.9 percent, providing a handsome arbitrage for the sector. Given that the inflation rate is running at 19.4 percent year on year, almost all loans are currently below the rate of inflation, making money in Venezuela almost free.

¶5. (SBU) Central Bank (BCV) regulations require banks devote a certain percentage of their loan portfolios to agriculture (18 percent), housing (10 percent), micro-credit (3 percent), and tourism (1.5 percent) (reftel A). A new banking law, expected to be issued via Chavez' decree powers during the second half of 2007, will probably increase directed lending

percentages, including adding sectors (such as industry). As of the end of May, banks had completed their mandated housing loans for the year, and obtaining a mortgage is expected to become quite difficult for the remainder of 2007. The BRV's obligatory savings fund (which receives one percent of salaries and a two percent matching contribution from employers) also offers mortgages, however its methodology is opaque and the decision-making process overtly political. Should supply not keep pace with demand, borrowers will be forced into the informal sector, where rates are much higher, or to chase precious formal loans with kickbacks or other under the table negotiations.

¶6. (SBU) Negative interest rates, coupled with increasing inflation and the continual threat of devaluation have affected Venezuelan consumption habits, with premiums placed on immediate gratification and on non-tradable goods that hold their value, such as cars and homes. According to a recent Economic Commission for Latin America and the Caribbean (CEPAL) report, Venezuelans spend 45.3 percent more on restaurants and hotels (per capita) than other Latin Americans, as anyone out in Caracas on a Friday night can attest. Car dealerships have waiting lists ranging from six months to over a year for new models, and most models increase in price after they are driven off the lot, as the shortage of cars has made them more valuable in the secondary market. A recent "El Universal" investigation estimated that new cars sold in the secondary market cost up to 49 percent more than from the dealership. The BRV has contributed to demand through its "Venezuela Movil" program, which subsidizes certain economy cars assembled in Venezuela, providing two percent loans with little money down.

INCREASING ACCESS

¶7. (SBU) Venezuela's bank network remains small, with 3,200

branches throughout the country of 27 million people (albeit up by 45 percent in the past three years). Total deposits have reached 30 percent of GDP, though loans as a percentage of GDP are only 12 percent and banking penetration remains low. Government and private initiatives to expand bank access to the barrios via micro credit schemes have had some success, however much work remains (septel).

¶8. (SBU) Most middle and upper class Venezuelans rely on credit cards to make it through the month, routinely spending their biweekly paycheck the weekend they receive it. For those with insufficient salaries to obtain credit cards, a common perk offered by employers is to co-sign on a card. Once the employee has a credit card s/he can obtain future cards and will maintain access to the system for life.

RISKY BUSINESS?

¶9. (SBU) Non-performing loan rates remain low in Venezuela, hovering between 1.1 and 1.2 percent. However, given the glut of liquidity and ease of obtaining credit cards, it is hard to say how many loans are being paid off with other loans. Many analysts admit that individuals and their banks maintain "off-budget" liabilities by borrowing from one another--from Peter to pay Paul. Venezuela's third largest bank, Banco Mercantil, currently offers up to a six month's advance on one's salary in credit card purchases and most banks have similarly permissive lending practices.

¶10. (SBU) The capitalization requirement (debt over equity) was reduced from 12 to 8 percent in 2006 and capitalization levels have since fallen, from 12.41 percent in May 2006 to 9.67 percent as of the end of May 2007. Thirty percent of assets acquired after July 14, 2006 (and 15 percent of older assets) must be held in reserve at the Central Bank. Banks can hold up to 30 percent of their assets in foreign currency, which helps them hedge against inflation and future devaluation.

¶11. (SBU) Senior bankers admit the theoretical problem of

non-performing loans in the event of a liquidity crunch. Many have confided to Econoff their concerns for the sector, while at the same time insisting that, in the case of their bank, risk was being well-managed. Given the government's history of bailing out failing banks, financial institutions here may see their risk capped by the knowledge that the government will step in if things get too bad. In addition, banks have been actively moving money offshore through accelerated dividend payments to protect against inflation and a potential devaluation, thus reducing their commitment in Venezuela should their bank ever require government intervention (reftel B).

COMMENT

¶12. (SBU) The explosion in credit in recent years has been caused by and contributed to the massive increase in liquidity. It has led mainly to increases in consumption (in non-tradable goods and massive import growth) that have raised prices considerably in Venezuela, though done little to increase investment or create jobs. Imports are expected to exceed USD 40 billion this year, up from USD 32.2 billion in 2006 and USD 23.7 billion in 2005. Banks seem to be well aware of the risk posed by expanding credit portfolios, yet hard-pressed to curtail such a valuable profit center. Reserve requirements, assets held in hard currencies, and the theoretical guarantee of government protection may cushion a future downturn, but should liquidity retract quickly, many Venezuelans would be hard-pressed to pay off their debt, though would be similarly loath to give up their goods.

BROWNFIELD